STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 98-984

January 13, 1999

BANGOR HYDRO ELECTRIC COMPANY
Re: Request for Accounting Order on PERC Restructuring Costs

ACCOUNTING ORDER

I. SUMMARY

In this Order we approve Bangor Hydro Electric Company's ("BHE" or the "Company") request to defer and create a regulatory asset for the various costs associated with the Company's restructuring of its power purchase agreement with the Penobscot Energy Recovery Company ("PERC"). The Commission approved the PERC restructuring agreement in Docket 97-451, but indicated that it would not approve the accounting treatment until the costs were known with more specificity and the Company filed an explicit request seeking deferral and recovery. We do not approve the ratemaking treatment for recovery of the deferred expenses, except to the extent such recovery was approved in our Order in Docket No. 97-116, BHE's most recent general rate case. Any additional ratemaking treatment for the expenses will be decided in Docket No. 97-596 or in a subsequent rate proceeding involving the Company.

II. DISCUSSION

In Docket No. 97-451 the Commission approved a restructuring of the power purchase agreement between BHE and PERC. In its present request, BHE asks the Commission to issue an accounting order allowing it to do the following: 1) defer and establish a regulatory assets for all of the costs involved in the restructuring; 2) begin the amortization of the deferred costs at the rate of $1.0 million per year from July 1, 1998 through February 29, 2000, as established by the Commission in Docket No. 97-116; 3) amortize the remaining balance of deferred costs at March 1, 2000, over the remaining life of the PPA ending July 1, 2018, with amount of amortization to be determined in Docket No. 97-596; and 4) include the unamortized balance in rate base for ratemaking purposes. The Company's filing is in compliance with the Commission's Order in Docket No. 97-451 requiring BHE to seek specific accounting approval for deferral and recovery of the restructuring costs after the closing on the agreement and after the costs were known and measurable.

The restructuring agreement was designed to, among other things, reduce the Company's net cost of power purchased from the plant by the payment of performance credits to the Company over the remaining life of the contract. The agreement was financed through the use of lower-cost borrowing using borrowing by Finance Authority of Maine ("FAME") that is repaid by PERC with a guarantee of payment by Bangor Hydro. The agreement also involved the Municipal Review Committee, an organization representing the interests of the municipalities which deliver trash to the plant for use as fuel. The Commission initially approved the agreement in an Order (Part II) issued October 10, 1997. In addition, in an Order issued on May 13, 1998, the Commission approved a stipulation that included certain changes to the original restructuring agreement. In these orders the Commission approved the restructuring deal and found explicitly that the following costs of the agreement were recoverable from ratepayers: 1) $10 million in payments ($6 million at closing and $4 million in quarterly amounts over 4 years) by BHE into a PERC reserve account, to be used as a reserve against the debt service payments required under the FAME financing provisions, with any remaining balance to be distributed equally among the 3 parties to the agreement at the end of the PPA term in 2018; 2) up to $160,000 in prepaid interest on $1 million of the deferred payments (the actual amount of prepaid interest is $151,000); and 3) the cost of stock warrants, up to the cap imposed by the Commission, issued to PERC and the MRC. The Commission did not explicitly declare that the closing costs that the Company now seeks to recover ($1,401,856) were recoverable from ratepayers, but the Commission clearly implied that such would be the case, in accordance with the statute allowing the use of FAME funding for the agreement, as long as the costs were shown to be prudently incurred. While we have not thoroughly reviewed all of the claimed closing costs, our preliminary review indicates that the costs appear reasonable, but we reserve final judgment for the Company's current rate proceeding, Docket No. 97-596.

The Commission's Order in Docket No. 97-116 incorporated into the Company's revenue requirement a proposed adjustment to begin amortization of the PERC restructuring cost at the rate of $1 million annually. While the rates ordered by the Commission in that case became effective on February 13, 1998, the Order did not specifically state when the amortization of the deferred PERC costs was to begin. The Company completed its PERC restructuring agreement in June of 1998, and thus it was unable to know the exact amount of the closing costs and the prepaid interest until that time. More importantly, there would be no need for any amortization if, for some unanticipated reason, the agreement had not been closed. The Company has proposed to begin amortization of the restructuring costs on July 1, 1998, at the rate of $1 million per year. This amount would remain in effect until our decision in the currently-ongoing rate case, Docket No. 97-596, takes effect, presumably on March 1, 2000. Under the Company's proposal in the present case, the Company would amortize $83,333 per month for the twenty months from July, 1998 through February, 2000, or a total of $1,666,666. Because rates became effective on February 13, 1998, however, the Company would "recover" through rates approximately $2 million. If the Company's proposal were accepted, a mismatch of rates and expense recovery would result, and BHE would receive an unintended "windfall" recovery. In order to prevent that occurrence, we find that the Company should amortize the deferred costs associated with the PERC restructuring at the rate of $100,000 per month beginning on July 1, 1998, and continuing through February 29, 2000. During that 20-month period, the Company will amortize $2,000,000 on its books, which is approximately equal to the amount its rates are designed to recover during the period that rates approved in Docket No. 97-116 are in effect. While the Company has presented a proposed amortization amount and schedule in the present case, we will determine the amount of amortization that will be effective at March 1, 2000, and the recovery period for the deferred balance in the Company's rate case proceeding. As has been the practice with other regulatory asset deferrals, we will allow the Company to include the unamortized balance of deferred PERC costs in its rate base at the time of any general rate case proceeding, such the current rate proceeding.

As for the costs of the stock warrants, the Company may defer the costs of such warrants up to the limit imposed by the Commission in Docket No. 97-451. The warrants become exercisable in increments of 500,000 beginning 9 months after the date of the closing, and continuing at intervals of twelve months thereafter. The cost deferral will occur if and when the warrants are actually exercised by the holder and the Company is able to calculate the deferrable amount.

Accordingly, we

O R D E R

1. That Bangor Hydro-Electric Company is authorized to defer a total of $10 million ($6 million at the time of closing and an additional $4 million to be made in equal quarterly payments over a 4-year period) in payments made into the PERC Capital Reserve Fund;

2. That the Company is authorized to defer $151,393 in prepaid interest costs that were paid into the Capital Reserve Account at the time of the closing;

3. That the Company is authorized to defer $1,401,856 in closing and other costs related to completing the PERC restructuring transaction;

4. That if any of the stock warrants issued in connection with the PERC restructuring are exercised, the Company is authorized to defer the difference between the exercise price of $7 per share and the market price of the stock up to the greater of $15 per share or the Company's net book value per share at the time the warrants are exercised;

5. That the Company shall begin amortizing on its income statement the deferred costs of the PERC restructuring at the rate of $100,000 per month as of July 1, 1998;

6. That the Company may include the net unamortized balance of the deferred amounts authorized herein in its rate base in any general rate case proceeding before the Commission; and

7. That all deferrals authorized herein shall be recorded in account 186, shall be separately maintained and identified, and shall be adjusted to account for any tax-timing effects that may result from the deferrals.

Dated at Augusta, Maine, this 13th day of January, 1999.

BY ORDER OF THE COMMISSION

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Dennis L. Keschel
Administrative Director

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COMMISSIONERS VOTING FOR:	Yes [ ]	No [ ]	Absent [ ]	Welch
	Yes [ ]	No [ ]	Absent [ ]	Nugent
	Yes [ ]	No [ ]	Absent [ ]	Diamond

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